

## Illustration of the **Four Components of "Return on Investment"**

### 1 **Cash Flow**

This first and perhaps most obvious component is "cash flow" - rental income minus expenses - or how much cash ends up in your pocket.

53,137	+	Rental Income
17,902	-	Operating Expenses
23,652	-	Mortgage Payments
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11,583	=	Cash Flow
118,500	/	Downpayment + Closing Costs
9.8%	=	Return on Investment from Cash Flow

### 2 **Appreciation**

As the value of the property increases, your return on investment increases.

395,000	=	Acquisition Price
5%	*	First Year Appreciation
414,750	=	Value at the end of Year 1.
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19,750	=	Amount of Value Increase
118,500	/	Downpayment + Closing Costs
17%	=	Return on Investment from Appreciation

### 3 **Equity Build-Up**

7.00%      30 \$      1,970.96

Even if the property did not increase in value, Equity will increase solely from paying down the mortgage.

296,250	=	Loan Amount at Closing
293,241	=	Loan Amount at the end of Year 1
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3,009	-	Equity Build-Up in Year 1
118,500	/	Downpayment + Closing Costs
2.5%	=	Return on Investment from Equity Build-Up

### 4 **Tax Benefits**

One pays less income taxes on a real estate investment than on other investment vehicles.

35,235	=	Cash Flow Before Loan Payments (rents less expenses)
11,192	-	Depreciation (assumes 15% land, 30 year recovery)
20,642	-	Mortgage Interest
3,401	=	Taxable Income Year 1
2,721		Less 20% Exclusion for LLC Ownership under new tax law
37%	*	Marginal Tax Rate
1,006.74	=	Federal Income Tax
1,007		Federal Income Tax
11,583	/	Cash Flow
8.7%	=	Effective Tax Rate on This Investment
4,286	=	Tax if Cash Flow came from a non-preferred investment vehicle
1,007	-	Tax from this preferred investment vehicle.
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3,279	=	Income Tax Savings
2.8%		Return on Investment from Tax Savings

### **Total / Summary**

1:	11,583	Cash Flow
2:	19,750	Appreciation Year 1
3:	3,009	Equity Build Up Year 1
4:	3,279	Tax Savings Year 1
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	37,622	Total Return from this Investment
	118,500	Downpayment + Closing Costs
	31.7%	Total Return from this Investment

**Illustration of Internal Rate of Return over a 10-Year Holding Period  
2822 GUILFORD AVENUE**

Purchase Price	395,000	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Annual Rent	4.0%	53,137	55,263	57,473	59,772	62,163	64,650	67,236	69,925	72,722	75,631
Vacancy	3.0%	1,594	1,658	1,724	1,793	1,865	1,939	2,017	2,098	2,182	2,269
Effective Income		51,543	53,605	55,749	57,979	60,298	62,710	65,219	67,827	70,541	73,362
Expenses	4.0%	17,902	18,619	19,363	20,138	20,943	21,781	22,652	23,558	24,501	25,481
Exp as a percent of Annual Rent		35%	35%	35%	35%	35%	35%	35%	35%	35%	35%
Exp per unit	3	5,967	6,206	6,454	6,713	6,981	7,260	7,551	7,853	8,167	8,494
NOI	0	33,641	34,986	36,386	37,841	39,355	40,929	42,566	44,269	46,040	47,881
Debt Service	\$ 1,971	23,652	23,652	23,652	23,652	23,652	23,652	23,652	23,652	23,652	23,652
<b>Before Tax Cash Flow</b>	<b>(118,500)</b>	<b>9,989</b>	<b>11,335</b>	<b>12,734</b>	<b>14,190</b>	<b>15,704</b>	<b>17,278</b>	<b>18,915</b>	<b>20,618</b>	<b>22,388</b>	<b>298,486</b>
<b>18.0% Internal Rate of Return</b>											
NOI		33,641	34,986	36,386	37,841	39,355	40,929	42,566	44,269	46,040	47,881
Less Interest		20,642	20,425	20,191	19,941	19,673	19,385	19,077	18,746	18,392	18,011
Less Depreciation		10,533	10,533	10,533	10,533	10,533	10,533	10,533	10,533	10,533	10,533
Taxable Income to Individuals		2,465	4,029	5,661	7,367	9,149	11,011	12,956	14,989	17,115	19,337
Pass Thru Entity	20%	(493)	(806)	(1,132)	(1,473)	(1,830)	(2,202)	(2,591)	(2,998)	(3,423)	(3,867)
Taxable Income	0	1,972	3,223	4,529	5,893	7,319	8,808	10,365	11,992	13,692	15,469
Tax @ *	37%	730	1,192	1,676	2,181	2,708	3,259	3,835	4,437	5,066	5,724
<b>After Tax Cash Flow</b>	<b>(118,500)</b>	<b>9,260</b>	<b>10,143</b>	<b>11,059</b>	<b>12,009</b>	<b>12,996</b>	<b>14,019</b>	<b>15,080</b>	<b>16,181</b>	<b>17,322</b>	<b>245,001</b>
<b>15.0% Internal Rate of Return</b>											
Purchase	395,000										
L-V	75%										75,631
Loan	296,250										7.4
Down Payment	98,750										562,208
Cap Improvement	-										33,732
Closing Costs	19,750										289,667
Initial Investment	118,500										238,809
Rate	7.00%										47,762
Term	30										254,219
P&I	\$1,970.96										274,256
											226,495
<b>Mortgage Amortization</b>		1	2	3	4	5	6	7	8	9	10
296,250 Beg Bal		296,250	293,241	290,014	286,554	282,843	278,865	274,599	270,024	265,119	259,859
7.00% Prin		3,009	3,227	3,460	3,710	3,979	4,266	4,575	4,905	5,260	5,640
30.0 Int		20,642	20,425	20,191	19,941	19,673	19,385	19,077	18,746	18,392	18,011
1,971 Bal EOY		293,241	290,014	286,554	282,843	278,865	274,599	270,024	265,119	259,859	254,219
<b>Cost Recovery / Depreciation</b>		395,000	395,000	Building	80%	316,000	Land	20%	79,000	Life	30
		10,533	10,533	10,533	10,533	10,533	10,533	10,533	10,533	10,533	10,533
Basis		384,467	373,933	363,400	352,867	342,333	331,800	321,267	310,733	300,200	289,667

\* Tax rate of 35% applies to income of \$200,001 to \$500,000 for singles; \$400,001 to \$600,000 for married filing jointly. Marginal rate above \$500k/\$600k is 37%.